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U.S. Farm Policy and the WTO

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U.S. Farm Policy and the WTO

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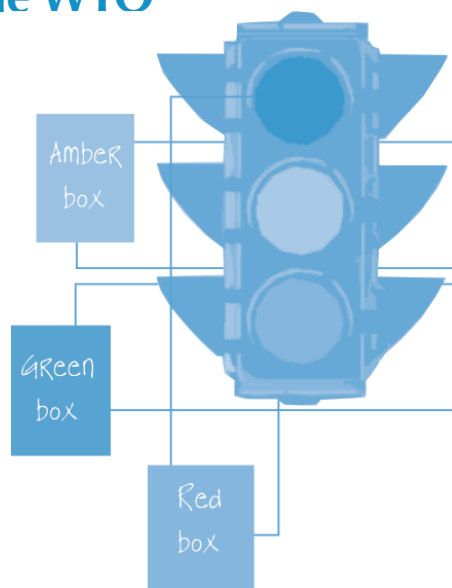
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How is your proposal WTO-compliant? This is a question that farm groups must be prepared to answer when they travel to Washington looking for increased subsidies. That an international trade agreement should be playing such a prominent role in shaping U.S. farm programs may be surprising. But this prominence is likely to continue as long as the United States remains committed to expanding world trade through negotiated agreements.

Many people both inside and outside of agriculture do not realize that the United States put strict limits on its ability to subsidize U.S. farmers. It did this to win agreement from other countries to limit their own subsidies. Because we are a net exporter of agricultural products, U.S. producers should expect to see a gain from such trade-expanding agreements. But the downside of the agreement—at least from the point of view of U.S. producers—is that Congress no longer has complete freedom in its design of farm programs.

WHAT IS THE WTO?

The World Trade Organization (WTO) is the successor organization to the General Agreement on Tariffs and Trade (GATT). Its mission is to provide a mechanism to resolve trade disputes between



countries and to expand international trade by lowering existing barriers and preventing new ones. The WTO is an institution with staff members, but WTO is also used as shorthand to refer to sector-level trade agreements that exist within the WTO. Agriculture has such an agreement. It is called the URAA (Uruguay Round Agreement on Agriculture).

In the URAA, domestic subsidy programs are classified according to their impact on trade flows. The classifications are often described in terms of colored boxes: “green” for those programs that have minimal impacts on trade, “amber” for programs that have important impacts, and “blue” for programs that are explicitly allowed in the agreement. The URAA places no limits on green and blue box programs. Expenditures under amber box programs are limited. The analogy of a traffic stoplight adequately describes what can be done to sup-

port domestic producers under the WTO. Countries can continue (“Go”) all green and blue box programs at any level of funding. Countries may continue to use amber box policies as long as the expenditures on them do not exceed set levels (“Proceed with caution”). Outlawed policies are placed in a “red” box (“Stop”).

Detailed rules determine the classification of domestic subsidy programs. Blue box policies are production-limiting policies that base payments on fixed yields and acreage. Payments must be limited to 85 percent of the base level of production. The old U.S. target-price-deficiency payment program that existed before 1996 was a blue box program. Green box policies are those that have minimal trade impacts. Payments from green box policies cannot be linked to current production and/or prices.

Limits on amber box expenditures are based on a country’s level of support over a base period. The countries that signed the URAA agreed to limit amber box spending to a level at or below their level of support during the base period. Developed countries (for example, the United States, Canada, and Australia) and confederations (the European Union) agreed to 20 percent reductions in their amber box limits by 1999. Within the amber box, programs can be exempted from the limits if their payment amounts are considered too small to count. These exemp-

Continued

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IN THIS ISSUE

U.S. Farm Policy and the WTO	1
Iowa's Agricultural Situation	4
Can Acreage Controls Increase Iowa Farm Revenue?	8
USDA's Nutrition Education Program Pays Long-Term Benefits	9
Meet the Staff: Sandra Clarke	11
Recent CARD Publications	12

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tions are referred to as *de minimis* exemptions.

For developed countries, a 5 percent *de minimis* rule is used. For crop- or product-specific support, a policy can be declared *de minimis* if the expenditures under the policy are less than 5 percent of the value of production for the commodity. For non-crop- or non-product-specific support, all such policies can be declared *de minimis* if total expenditures under all of the policies are less than 5 percent of the total value of agricultural production in the country.

WHAT BOX FOR CURRENT U.S. PROGRAMS?

Farm groups want their policy proposals to be classified as green box, because that would mean that Congress would have complete freedom to fund the program at any desired level. However, few programs can be classified as green box. To see why, we can examine the classification of U.S. farm programs for the 1995-1997 marketing years, the only years that the United States has submitted reports to the WTO.

PFC Payments

The Production Flexibility Contract (PFC) payments, which are one cornerstone of the 1995 FAIR (Federal Agriculture Improvement and Reform) Act, fall in the green box. PFC eligibility requirements and the amount of payments are based on historical production patterns over a fixed base period. Current production decisions (even the decision not to produce at all) do not affect the size of the payment. Given that there is no link between current production and PFC payments, these payments should have no effect on future production and therefore are not trade distorting.

Price Supports and Marketing Loans

Price support and marketing loan programs fall in the amber box be-

cause payments depend directly on current production and prices. Given this link, the programs influence future production decisions and have trade-distorting effects. For example, current loan rates have fueled expansion of soybean acreage relative to corn and wheat acreage. The larger supply has decreased world soybean prices, expanded U.S. exports, and reduced other countries' soy exports. Clearly this direct effect on trade flows means that LDP payments fall in the amber box.

Crop Insurance Payments

The other major U.S. program currently available is the crop insurance program. Government-provided insurance or safety net programs are green box if

1. they insure income only from agricultural sources;
2. they insure losses only in excess of 30 percent of average gross income (or an equivalent amount of net income) where average income is determined by past income levels; and
3. indemnity payments combined with payments from a natural disaster relief program do not exceed 100 percent of the producer's total loss.

Net crop insurance payments (indemnities less the producer premium) clearly fall in the amber box because coverage above 70 percent is allowed and indemnities are not based on average past income levels.

Emergency Assistance

Over the last three years, the federal government has substantially increased agricultural subsidies with annual emergency assistance packages. These packages included market loss assistance (MLA) and crop loss assistance payments for several commodities. The crop loss assistance payments were constructed to be exempt from WTO limits. However, there is some question as to whether the MLA payments are amber or green

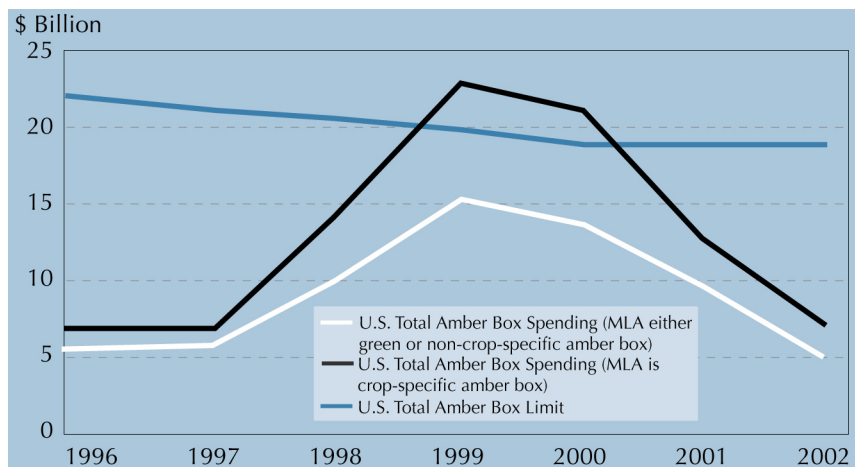
box. Clearly, Congress made the payments in response to low market prices. This suggests that they are amber box. But the payments are based on the PFC formulas that are green box, which suggests that they should be classified the same way. After all, there is no formula linking the payments to current market prices. Any link to current prices is derived from interpreting the intent of Congress.

There is also some question about whether the payments are crop-specific or non-product-specific. The structure of the payments is non-product-specific because current production has no impact on the payments. But the payment rates are crop-specific. How the MLA payments are classified makes a big difference because their classification determines whether or not the United States exceeded its amber box limits.

HAS THE U.S. MET ITS WTO COMMITMENTS?

Figure 1 shows that whether the U.S. has met its WTO commitments depends on whether the MLA payments are classified as amber or green box and whether they are classified as crop-specific or non-crop-specific payments. The blue line in Figure 1 shows the WTO amber box limits for the United States. The white line shows actual (for 1996 and 1997) or projected (after 1997) amber box payments if the MLA payments are classified either as green box or as non-crop-specific payments. The two classifications give the same result because as non-crop-specific payments, the MLA payments can be characterized as *de minimis*, and do not count toward amber box limits. They would be classified as *de minimis* because they do not exceed 5 percent of the value of total agricultural production.

However, as shown by the black line in Figure 1, if the MLA payments are classified as amber box and crop-specific payments, then the



Note: Actual numbers are reported for 1996 and 1997. Projections are made for 1998 and beyond.

FIGURE 1. Amber box commitments and spending levels under alternative classification of market loss assistance payments

United States has exceeded its amber box commitments. The difference arises because the payments for each crop would be compared to the value of each crop to determine if they could be classified as *de minimis* under the 5 percent rule. Our calculations indicate that they exceed the 5 percent rule, so they would count toward the amber box limits. As shown, this interpretation leads to higher amber box payments, adding enough to push the United States past its limits in both 1999 and 2000.

WHAT BOX FOR PROPOSED PROGRAMS?

As Congress attempts to design a new farm bill, judgments will have to be made regarding how new or adjusted policy complies with the amber box commitments shown in Figure 1. Policies that increase or rebalance the marketing loan rates change programs that are already marked as product-specific amber box spending programs. Given most price projections for 2001 and 2002, such changes would likely lead to higher amber box payments and push the United States even closer to its limit. The often-proposed flexible

fallow program would also be considered product-specific amber box spending, even though it has production-limiting features (like blue box programs), because the payments are triggered by current prices.

The Supplemental Income Payments (SIP) proposal is a product-specific amber box program because payments are triggered by shortfalls in current crop-specific prices or production. The Commission on 21st Century Production Agriculture's countercyclical proposal is non-product-specific as it looks at income across eight crops. But our interpretation of the URAA indicates that it also would be considered amber box because current prices and production from the eight crops are used to determine the overall amount of payments. New policies that include environmental payments could also fall into the amber box if the payment exceeds the additional cost or loss of income that producers face in implementing the requirements of the program.

Most current farm bill proposals keep the existing programs in place. This implies that any additional ex-

Continued on page 7

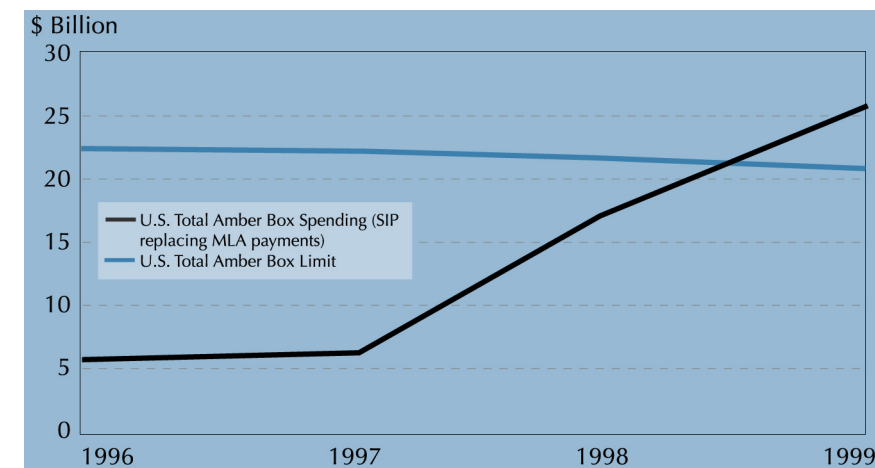
U.S. Farm Policy and the WTO
Continued from page 3

penditure from these proposals would add to the U.S. amber box spending (barring *de minimis* exemptions). Therefore, the probability of the United States exceeding its WTO domestic support limit would increase under these proposals. For example, if the SIP proposal with a 95 percent coverage level had been in place instead of the MLA payments, then the United States would have exceeded the amber box spending caps in 1999. Figure 2 shows the estimated payments and the extent to which we would have exceeded the limits.

As the URAA now stands, the goal of having a new countercyclical farm program conflicts with the goal of reducing trade-distorting policies. Most variations on a countercyclical farm program would fail to qualify for a green box exemption, due to their very countercyclical nature. After all, how can a program be countercyclical if it cannot be based on current prices and yields? Efforts to construct a green box countercyclical farm program would require a redefinition of the meaning of "countercyclical." Adding a new amber box countercyclical program might require the elimination of one or more existing policies. Such a move could be justified because both the price support and crop insurance programs provide countercyclical support. A new program could substitute quite effectively for either program.

WHY THE WTO?

Why might it make sense for the United States to place limits on its



Note: Actual numbers are reported for 1996 and 1997. Projections are made for 1998 and beyond.

FIGURE 2. Total amber box spending with a 95 percent SIP program

ability to subsidize agriculture? There are two reasons. The first is that as a large exporter of agricultural products, U.S. farmers will benefit from increased agricultural trade. Of course, some producers who compete directly with imports, such as producers of sugar, dairy products, and peanuts, would face increased competition from freer trade, but, overall, U.S. producers would be big winners from expanded trade. Thus, it makes sense for the United States to limit its subsidies in exchange for limits on other countries' subsidies. This is the standard explanation for why the WTO agreement makes sense.

The second reason why it might make sense for Congress and the administration to negotiate limits is that it strengthens the hand of those who believe increased subsidization of agriculture is not in the best interest of either agriculture or the coun-

try as a whole. That is, WTO limits place an upper bound on the level of "coupled" support that can be given to agriculture. Coupled support means farmers' production decisions are influenced by the program as well as by market signals. Not surprisingly, policymakers find it easier to say no to farm groups if there is some external constraint that they can point to. Congress and farm groups are finding that the WTO agreement is one such constraint, a constraint that works to limit the effects of farm programs on domestic and world markets. ♦